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HAROLD B. WILLEY, Clerk

Supreme Court of the United States

October Term, 1952

No. 729

JOHN W. WILLIAMSON, JOHN W. WILLIAMSON AND INEZ WILLIAMSON, PETITIONERS,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT WITH SUPPORTING BRIEF

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COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT WITH SUPPORTING BRIEF

To the Honorable the Supreme Court of the United States:

Your petitioners respectfully show:

SUMMARY STATEMENT OF THE MATTER INVOLVED

This case involves the question of whether gain from call contracts involving the disposition of cotton is taxable as ordinary income or as capital gain. For the year 1945

the petitioner John W. Williamson and for the year 1946 the petitioners John W. Williamson and his wife, Inez Williamson, in their federal income tax returns reported gain from call contracts as capital gain. The Commissioner took the view that such gain was ordinary income and assessed the petitioners with an income tax deficiency. The Tax Court affirmed the Commissioner, making a finding of fact that the cotton disposed of by call contracts was held by the taxpayer for sale in the ordinary course of business [R. 6]. The Court of Appeals for the Fourth Circuit affirmed the Tax Court [R. 44-49].

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is involved under Section 240 (a) of the Judicial Code (28 U. S. C. A. 347 (a)) which provides as follows:

> "(a) In any case, civil or criminal, in a circuit court of appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought thereby unrestricted writ of error or appeal."

QUESTION PRESENTED

Are profits from cotton call contracts taxable as ordinary income or as capital gains?

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

There are two reasons why this Court should review and decide this case. *First:* The case presents an important

question concerning the application of the federal income tax law, which has not been, but should be, settled by this Court. *Second:* The decision of the Fourth Court of Appeals is apparently in conflict with the decision of the Fifth Circuit Court of Appeals in the case of *Commissioner v. Covington,* 120 Fed. (2d) 768, Cert. den'd 315 U. S. 822, where commodity futures contracts were held to be capital assets.

I

The tax consequences of cotton "call" contracts were passed upon for the first time by any court to our knowledge in this case. The Court below, in its opinion said:

> "* * * Counsel have not called our attention to any cases dealing with the sale of commodities on call contracts, and we have found none * * *."

Trading in securities has been under the scrutiny of this court many times (*e. g. Schaefer v. Helvering,* 229 U. S. 171) as has been the sale of various other assets. But with the exception of "spot" sales, transactions in the commodity markets have peculiarities of their own. Some commodity contracts provide for future delivery of a commodity at a price set at the time of execution of the contract. Some provide for future determination of the price after the contract is executed and the commodity delivered. These contracts may then be traded and used as the basis for speculation or investment by persons who never actually see the commodity itself. These extensive commodity transactions should be given separate examination by this Court because of their *sui generis* nature. This case involves cotton "call' contracts held by the taxpayer in anticipation of favorable market fluctuations for more than six months and our contention is that these contracts should be treated as capital assets.

II

In *Commissioner v. Covington,* 120 F. (2d) 768, Cert. den'd 315 U. S. 822, it was held that losses from commodity futures transactions were capital losses. Taxpayer, president of a cotton seed processing company, traded in futures contracts in the commodity markets for various cottonseed products. The decision affirmed the Board of Tax Appeals (*Covington v. Commissioner,* 42 BTA 601) wherein the futures contracts were deemed to be capital assets. The Board's opinion stated:

> "In Future Trading, *supra,* p. 111, it is said that 'in dealing in futures one is dealing not in the actual commodity but in *claims* on or *contracts* for the commodity.' Accepting this approach, it would seem to follow that petitioner's losses were capital losses, as contracts are unquestionably property. Another view is that the contract slips evidencing the purchases and sales 'constitute bought and sold notes.'' *Bibb v. Allen,* 149 U. S. 481. Under this view the contracts are nothing more nor less than choses in action, and are of course property. Still another view is to treat future dealings as carrying out the original intent to make or take delivery and to ascribe to set-offs the effect of delivery."

In like vein was the concurring opinion of Circuit Judge Holmes on appeal:

> "* * * such contracts were intangible property which are deemed to have a value the instant they are made; their subsequent value or lack of value depends upon the market price of the commodity at the time of valuation. These contracts are capable of ownership and of being transferred by act of the parties or by operation of law. They are capital assets within the meaning of Sec. 117 (b) and (d) of the Revenue Act of 1936; * * *"

A call contract is essentially the same as a futures contract. In neither case is the actual commodity dealt in.

The futures contract entitles the holder to the actual commodity, at some time in the future. The call contract entitles the holder to the amount of money that the commodity would bring in the market at some time in the future.

WHEREFORE your petitioner prays that a writ of certiorari issue under the Seal of this Court, directed to the United States Court of Appeals for the Fourth Circuit commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said United States Court of Appeals for the Fourth Circuit in the case numbered and entitled on its docket, No. 6537, John W. Williamson and his wife, Inez Williamson, Petitioners, v. Commissioner of Internal Revenue, Respondent, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States Court; and that the judgment of said United States Court of Appeals for the Fourth Circuit be reversed by this Court, and for such further relief as to this Court may seem proper.

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SUPPORTING BRIEF

I

GROUNDS ON WHICH THE SUPREME COURT JURISDICTION IS INVOKED

This application is made upon authority of Section 240 (a) of the Judicial Code, as amended (28 U. S. C. A., Sec. 347 (a)).

II

STATEMENT OF CASE

The petitioners John W. Williamson and his wife, Inez Williamson reside in Norway, South Carolina. Petitioner John W. Williamson is primarily a farmer but he also owns and operates a cotton gin in Norway, a bonded cotton warehouse, a warehouse for cottonseed, a mercantile store in Norway and during the cotton season he buys a substantial amount of the cotton produced by local farmers (R. pp. 7-9).

From 1911, when he started buying cotton, until about 1940 he sold all of this cotton immediately as "spot" sales (R. 9). However, by 1940 he had acquired sufficient property to enable him to speculate and, when he thought the price of cotton was going to advance, he would hold some of the cotton purchased for future sales (R. 11-12). The United States District Court for the Eastern District of South Carolina decided that he was entitled to report his profit on this cotton as a capital gain (R. pp. 28-31). The Government did not appeal. In 1944, for the first time, the petitioner John W. Williamson, in lieu of holding cotton in his warehouse, disposed of some cotton under call contracts (R. 11).

A call contract is a combination of a spot sale and an investment in futures. The seller delivers specific bales of

cotton to the buyer, and the latter then agrees to pay therefor whatever the price for cotton futures contracts for delivery at some future date, maybe when the contract is "called". The buyer advances a certain percentage of the value of the cotton to the seller retaining an amount equal to what the seller would have to provide for the purchase of a cotton futures contract on margin. In the meanwhile if there are fluctuations in the cotton futures contract market of more than 10%, the buyer may call on the seller for more margin or the seller may draw a larger amount so long as the margin of at least 10% remains. The profit on the call contracts was reported as capital gains profit on cotton sold and this litigation developed therefrom.

III

ARGUMENT

1. **The cotton was exchanged for a call contract:**

The Court below fell into the same fundamental error as the Tax Court in accepting the finding that "the cotton in question was not a capital asset" because "it was held by the taxpayer for sale to customers in the ordinary course of his trade or business."

It was physically impossible for "the cotton in question", to be held for any purpose since it had already been appropriated to the call contract. The Government conceded at the hearing before the Tax Court that after the execution of the call contract the cotton was in the possession, control and worship of the buyer (Tr., p. 277), Mr. Walker, a partner of Joseph Walker & Company, cotton merchants of Columbia, South Carolina, who purchased some of the petitioners cotton on call, testified:

> "The COURT: Who has control over the physical cotton up to the time that the seller undertakes to make his call, or—

The WITNESS: Until the price is fixed, you mean? We have control of the cotton.

The COURT: Could you sell it meanwhile?

The WITNESS: We can sell it.

The COURT: Is it your practice to deal with it as if it were your own?

The WITNESS: We do anything we please. We use the cotton against some of our sales, maybe, or without anybody—Mr. Williamson's knowing anything about it.

The COURT: And that is the practice in the business?

The WITNESS: That is the practice. Yes, sir.

The COURT: And if the cotton has to be warehoused during that period, you pay the warehouse charges?

The WITNESS: That is correct, sir. (R. 20-21) * * *

Q. And that contract (the call contract), in effect, represents the cotton which had been delivered to you?

A. That is right." (R., p. 22).

How could the seller hold the cotton for any purpose when it is owned, controlled and possessed by the buyer?

If the finding refers to the cotton prior to its appropriation to the call contract, then the conclusion of the Court below, as well as the Tax Court, in imposing a tax upon the gain from a call contract, must be based on the principle that an asset takes its character from an asset that was exchanged for it in a closed transaction. A principle that cannot be justified. *Sunflower Packing Corp. v. Commissioner,* 2 B. T. A. 1104; *Peninsula Properties Co. Ltd. v. Commissioner,* 47 B. T. A. 84.

2. **A sale under call is a price speculation by the seller:**

The taxpayer can sell immediately as spot cotton all the cotton which he purchases. When he does this he does

not assume a price risk. On the other hand, where he disposes of his cotton under a call contract, or stores it for future sales, he does assume the risk of market changes. **The tax consequences where he does not assume the risk of market fluctuations and where he does assume that risk must be different.** The fact that the transaction is referred to as "a sale of cotton under call contracts" instead of technically exchanging the cotton for a call contract is unimportant for this purpose. The reality is that the petitioner was speculating. As the Fifth Circuit Court of Appeals said in the case of *Allen v. Beazley,* 157 Fed. (2d) 970:

> "We know * * * that the taxing authorities may—and we think that they should—look at the actualities, the substance, the realities, and not the form of the transaction, in determining * * * tax liabilities."

Where the profit is from speculation and not from merchandising, the property cannot come within the exclusion from the definition of a capital asset. This distinction is the very essence of all court decisions on the question. *George R. Kemon et al. v. Commissioner,* 16 T. C. 1026 (1951).

> "Contrasted to 'dealers' are those sellers of securities who perform no * * * merchandising functions and whose status as to the source of supply is not significantly different from that of those to whom they sell * * * The sellers depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost. Such sellers are known as 'traders'."

Mr. Alston Hill Garside, former Economist for the New York Cotton Exchange, in the only authoritative work on this subject "Cotton Goes to Market" brings out (pp. 174-179) that almost three quarters of the cotton crop each year is purchased initially from the growers by ginners, storekeepers, other local merchants or business in the

vicinity, who buy and sell the cotton as a sideline during the cotton season; these buyers mostly dispose of the cotton immediately, but in a few instances "when market conditions appear to indicate that prices are going to advance" they will hold the cotton or sell it on call. In Chapter XXIII of his work Mr. Garside says:

> "An authoritative dictionary defines speculation as meaning, 'to purchase or sell with the expectation of profiting by anticipated, but conjectural, fluctuations in price.' (From Webster's New International Dictionary.) A speculator is one who trades with that point of view and objective. It is important to note that, as the dictionary points out, the fluctuations in price which form the basis of the speculator's operations are 'conjectural.' The speculator deliberately assumes the risk of loss from an adverse movement of the price because he believes that the price will move in the direction that he anticipates, and so he will make a profit rather than take a loss. He is a bearer of price risks.
>
> "If these definitions are accepted, it will be agreed that everyone who buys or sells cotton with a view to making profit from a change in the price level is a speculator, regardless of whether he is in the trade itself, as a regular handler of cotton or consumer of the staple, or is outside of the trade, as, for example, a businessman in some other industry or a general investor. * * *
>
> "The essential fact is that speculative trades in cotton, whether within the cotton trade or outside of it, are underwriters of the price risks that are inherent in the merchandising of the cotton crop."

With due respect to the Court of Appeals we submit that the decision below ignores the realities of the call transaction. There can be no doubt that the taxpayer disposed of the cotton which he sold under call in such manner as to incur the risk of market fluctuations. If Mr. Williamson had sold the cotton as spot and immediately in-

vested the proceeds in cotton futures contracts, there would have been no question raised by the Bureau. From the point of view of substance and not form that is exactly what happened. Under the call contract the price of the cotton when the contract is called is the amount received when futures contracts are sold by the buyer "upon receipt of notice from seller to fix the price." Mr. Williamson, after delivery of cotton under call, possessed only an intangible property right subject to appreciation or depreciation in value.

Property acquired for speculation is a capital asset. In *George R. Kemon et al. v. Commissioner, supra,* it appeared that the taxpayer's partnership purchased securities of unlisted real estate corporations and held some for less than six months and some for more than six months. The Court said:

> "But whatever the firm's status may be as to the securities held for not more than six months, the evidence taken as a whole clearly establishes that as to the remaining securities the firm was a trader holding them primarily for speculation or investment."

The Tax Court and the Circuit Court of Appeals attempted to treat the transaction as though it were a spot sale of cotton at the price realized in the future when the contract was called; giving no effect whatever to the fact that in the intervening months between the date of the contract and the time when it was called there were market fluctuations which the seller incurred until the price was fixed.

We submit that this was erroneous. If the transaction is to be deemed a spot one, the consideration for the cotton delivered is not the money subsequently realized by the seller but is the call contract itself which merely represents an obligation by the buyer to pay the seller the price

of futures contracts for this quantity of specified cotton when the price is fixed.

In *Commissioner v. Covington,* 120 Fed. (2d) 768 (1941), the Fifth Circuit Court of Appeals held that although the taxpayer was in the business of buying and selling commodities, "or rights in commodities" its transactions in commodity futures, where not used for hedging purposes, were capital transactions.

3. **Conclusion:**

The taxpayer in the case at bar exchanged cotton for "call" contracts, which are in essence futures contracts. He did not hedge but like the taxpayer in the *Covington case* assumed all risks of market fluctuations. These have the same attributes of property as the futures contracts under discussion in the *Covington case* (*supra*). The Court of Appeals did not refer to the *Covington case* in its opinion although it was cited and discussed in the taxpayer's brief. The Court ignored the concept of the "call" contracts being capital assets separate and distinct from actual bales of cotton. It treated the transactions as if they were "spot" sales of cotton holding the Petitioner to be a dealer in cotton. Even if he is a dealer in cotton there is no finding that he is a dealer in cotton call contracts or futures contracts. In the transactions involved he was a trader or speculator in the commodities market trading in contracts for commodities as was the taxpayer in the *Covington case.*

Respectfully submitted,

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April 7, 1953.

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 729

JOHN W. WILLIAMSON AND HIS WIFE, INEZ WILLIAMSON, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3–7) are reported in 18 T. C. 653. The opinion of the Court of Appeals (R. 44–49) is reported at 201 F. 2d 564.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1953 (R. 49). The petition for a writ of certiorari was filed on April 20, 1953. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether on the evidence the Court of Appeals properly affirmed the Tax Court's decision that taxpayer's[1] sales of cotton by "call" arrangements were, like his "spot" sales of cotton, not sales of capital assets within the meaning of Section 117 (a) (1) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> (a) *Definitions.*—As used in this chapter—
>
> (1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *;
>
> * * * * *
>
> (26 U. S. C. 1946 ed. 117.)

STATEMENT

The facts as stipulated and found by the Tax Court (R. 3–7) may be summarized as follows:

John W. Williamson and his wife Inez, the taxpayers, reside in Norway, South Carolina (R. 3).

Taxpayer's business during most of his adult life has involved cotton. Since 1940 his activities

[1] John W. Williamson is referred to as the taxpayer throughout this brief, Inez Williamson being involved only because a joint return was filed for the year 1946.

have included ownership of some 1,000 or 1,200 acres of land near Norway, farmed by sharecroppers, on which cotton was an important crop; and ownership and operation of a cotton gin in Norway, a cotton warehouse, bonded under federal laws, two cottonseed warehouses, and a small mercantile store which sold fertilizer and other supplies to nearby farmers (R. 4).

Farmers in the vicinity of Norway, both taxpayer's sharecroppers as well as others, brought their cotton to taxpayer's gin for ginning. Taxpayer purchased about 80 percent of the cotton which passed through his gin with the intention of reselling it for a profit (R. 4–5).

In disposing of the cotton thus acquired the taxpayer had three alternatives open to him. First, he could resell the cotton at once as "spot" cotton thereby immediately realizing a profit. Secondly, if he felt that the market would rise during the ensuing months he could store the cotton and sell it later when he felt that the opportune moment had arrived. Or, as his third alternative, he could place his cotton on "call" which would enable him to profit by a rise in the market just as though he had stored the cotton for sale at a subsequent time. It was the taxpayer's employment of this third method for disposing of his cotton in the taxable years which gave rise to the tax controversy here involved (R. 5).

Under this third method taxpayer shipped the cotton at once to one of the cotton merchants with whom he regularly dealt, who got control over and could at any time resell the cotton; a provisional price was fixed for the cotton based on market quotations on the day the particular "call" transaction was initiated; taxpayer was given a specified time in which to "call" the contract and the actual price for the cotton was based on the market price on the day he notified the merchant of the "call." If the market rose or fell prior to the call date, payments were required of the merchant or the taxpayer to maintain a margin of not less than 20 percent between the current market value of the cotton and the net amount paid by the merchant to the taxpayer up to that time. Final settlement between the parties was based on the market on the "call date." No interest was paid either by the taxpayer or the merchant. The 80 percent paid to the taxpayer by the merchant was not a loan, but was a tentative part payment for cotton which taxpayer had sold to the merchant, the ultimate price to be determined by reference to market conditions as of some future date. Taxpayer did not enter into any "hedging" transactions (R. 5–6, 46).

Taxpayer's purchases of cotton from the farmers and the resale of such cotton, whether by "spot" sales, or "call" arrangements or otherwise, were not casual or occasional transactions.

They were a significant and regularly recurrent aspect, each season, of his overall cotton business. The few cotton merchants to whom he sold the cotton were his regular customers in the course of his business (R. 6).

On his tax returns for the years 1945 and 1946, the taxpayer treated the profits realized from sales of cotton on "call" arrangements as gains realized from sales of capital assets. The Commissioner asserted deficiencies against him for those years of $2,725.59 and $35,887.59, respectively, on the ground that the profits were ordinary income (R. 3). The Tax Court sustained the Commissioner (R. 7) and the Court of Appeals affirmed (R. 49).

ARGUMENT

This case does not warrant further review. Contrary to the assertion of the taxpayer (Pet. 2–3), the decision does not involve a question of general importance which should be settled by this Court, and it is not in conflict with *Commissioner* v. *Covington,* 120 F. 2d 768 (C. A. 5th), certiorari denied, 315 U. S. 822. Moreover, the decision is clearly correct.

1. Taxpayer's petition fails to show that the decision in his case will affect any pending case or that it has any importance beyond his case. As will appear more fully *infra,* the issue involved is primarily factual and is obviously not of such general importance as to merit review by this Court.

2. The question decided by the Fifth Circuit in *Commissioner* v. *Covington, supra,* was that commodity futures constituted "property" within the definition of "capital assets" in Section 117 (a) (1) of the Internal Revenue Code, *supra,* p. 2. Here, no contention has been made that the cotton or the call contracts were not "property" within the meaning of that section, and the issue is only whether, as both lower courts found, the "property" was held primarily for sale to customers in the ordinary course of business so as to be excluded from the definition of capital assets. The purpose for which the futures were held was not an issue in the *Covington* case. Furthermore, since the Fifth Circuit in that case held (p. 770) that trading in commodity futures consisted of buying and selling the commodities or rights in the commodities, it is obvious that it did not regard the futures contracts as separable from, and independent of, the commodities which they covered. Consequently, the view of the Court of Appeals in this case that the profits from call arrangements were realized from the sale of cotton and not from independent and separable "call" contracts is not in conflict.

3. The decision is correct. The contention that taxpayer exchanged his cotton for call contracts and that he then speculated in the call contracts as separate and independent transactions from the cotton disposed of was correctly rejected by both

lower courts (R. 6, 48–49). There is no basis in the facts for disassociating the cotton from the call arrangement and, as two courts have now examined the evidence and so concluded, there would seem to be no justification for consideration anew by this Court. *Tennessee Coal Co.* v. *Muscoda Local,* 321 U. S. 590, 605; *District of Columbia* v. *Pace,* 320 U. S. 698, 702; *United States* v. *O'Donnell,* 303 U. S. 501, 508. Further, even assuming, *arguendo* only, that taxpayer "exchanged" his cotton, which was not a capital asset, for call contracts in separate transactions, under Sections 22 (a) and 112 (a) of the Code, he would be taxable in full on the gain derived from the "exchange" since such a transaction does not come within any of the exceptions in Section 112 (b). There is no showing that such gain would not be the full equivalent of the gain with which taxpayer has been charged in the decision below.

The circumstance that taxpayer assumed the risk of market fluctuations in selling cotton under call contracts has no pertinence, contrary to his apparent contention (Br. 8–12), to the definition of capital assets in Section 117 (a) (1), as the Court of Appeals correctly pointed out (R. 48–49). Taxpayer does not dispute the Tax Court's findings that all the cotton he bought was acquired and was held primarily for resale to customers in the ordinary course of his business (R. 4–5, 6), and these findings are determinative that the cotton

was not a capital asset under the statutory definition. In *Kemon* v. *Commissioner,* 16 T. C. 1026, cited by taxpayer (Br. 9, 11), there was a specific finding (p. 1032) that the particular property involved was held for speculation or investment and was *not* held primarily for sale to customers in the ordinary course of business. Here, as stated, the Tax Court's finding on the crucial point under the statute was to the contrary.

CONCLUSION

The decision below is correct. There is no conflict in decisions and no other reason appears which would warrant further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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